

How to Avoid Obsolete Inventory

by Rick Pay

Obsolete inventory is one of the largest components of inventory cost, and is often larger and more costly than executives are willing to admit. Many suggest that there is no such thing as obsolete inventory because it will sell...someday. I have developed a new three-letter acronym for this to go along with JIT, RAW, WIP, and FGI: GSM for Glacially Slow Moving! Many studies related to inventory cost and inventory reduction prove that obsolete inventory exists, however, the important question isn't how to get rid of it, but how to avoid it in the first place.

Why does obsolete inventory build up? The root cause is uncertainty in both supply and demand. Reduce the uncertainty and you diminish your exposure to obsolescence. Three tools can accomplish this: 1) Sales and

Operations Planning, 2) Auto-replenishment systems, and 3) Ramp-up/Ramp-down discipline.

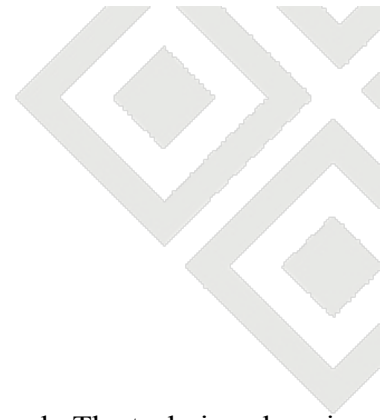
If you are experiencing growth in obsolete inventory, missed forecasts, reduced earnings, and increased backlogs, consider taking major action through Sales and Operations Planning (S&OP). S&OP strategies closely integrate the supply and demand planning processes which allow the business to provide the right products/services at the right time in the right quantity at the lowest possible cost. A tight connection between operations capabilities and sales demand planning enhances profitability, performance, customer satisfaction and return on investment, all while lessening exposure to potential obsolete inventory. Recent studies by the Aberdeen Group show that

S&OP can boost profitability, delivery and cash flow (regardless of company size) by as much as 40%.

Auto-replenishment systems are another valuable means of preventing obsolete inventory. As their name suggests, they



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automatically replenish inventory without using systems like MRP. The two most common are Vendor Managed Inventory (VMI) and Kanban. Recently I helped a client double their inventory turns (from 6 to 12!) in about 6 months using these methods. During the same period they trimmed their average order lead-time from over 90 days to about 30 and the numbers are still improving!

The VMI approach asks suppliers to come on site and determine needed inventory, order it, receive it and often even put it away in point-of-use locations. Such systems must be managed correctly, but VMI has the power to reduce both stock-outs and excess inventory. Kanban, a Japanese technique that uses a card or other visual

trigger to replenish inventory, is usually implemented as a two-bin system. When one bin is empty, a signal is sent to the in-house or out-of-house supplier to replenish in a fixed quantity. Both approaches can improve overall inventory turns, inventory accuracy, and reduce stock-outs.

The last tool is what I call Ramp-up/Ramp-down. This is the process of introducing new products/parts into the inventory system and eliminating old ones. I often see companies over-stock new items that they think are sure to sell. Of course, sales don't always show up immediately or in big numbers, and before you know it, GSM is beginning to build. Ramp-down is the process of recognizing that certain products/parts are going to be superseded and must be

reduced. The technique here is to put someone (usually materials group/purchasing) in charge of this process and keep them actively engaged with sales and new product development.

Do you have obsolete inventory? Are you willing to own up to it? If you're ready to reduce your GSM quotient, take a close look at what S&OP, Auto-replenishment systems and Ramp-up/Ramp-down can offer. These three approaches, properly implemented, can help you avoid obsolete inventory and add to your bottom line.

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